SONIC FOUNDRY INC
Form 10-Q
May 03, 2010
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly period ended March 31, 2010

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 1-14007

SONIC FOUNDRY, INC.

(Exact name of registrant as specified in its charter)

MARYLAND	**39-1783372**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

222 West Washington Ave, Madison, WI 53703

(Address of principal executive offices)

(608) 443-1600

(Registrant s telephone number including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (see definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act).

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

State the number of shares outstanding of each of the issuer s common equity as of the last practicable date:

Class	**Outstanding April 30, 2010**
Common Stock, $0.01 par value	3,615,215

Table of Contents

TABLE OF CONTENTS

		PAGE NO.
PART I	*FINANCIAL INFORMATION*	
Item 1.	Condensed Consolidated Financial Statements	
	Condensed Consolidated Balance Sheets (Unaudited) March 31, 2010 and September 30, 2009	3
	Condensed Consolidated Statements of Operations (Unaudited) Three months and six months ended March 31, 2010 and 2009	4
	Condensed Consolidated Statements of Cash Flows (Unaudited) Six months ended March 31, 2010 and 2009	5
	Notes to Condensed Consolidated Financial Statements (Unaudited)	6
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	16
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	23
Item 4.	Controls and Procedures	23
PART II	*OTHER INFORMATION*	
Item 1.	Legal Proceedings	24
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	24
Item 3.	Defaults Upon Senior Securities	24
Item 5.	Other Information	24
Item 6.	Exhibits	25
Signatures		27

Table of Contents

Sonic Foundry, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except for share data)

	(Unaudited) March 31, 2010	September 30, 2009
Assets		
Current assets:		
Cash and cash equivalents	$ 2,863	$ 2,598
Accounts receivable, net of allowance of $105 and $105	3,963	3,741
Inventories	108	440
Prepaid expenses and other current assets	439	472
Total current assets	7,373	7,251
Property and equipment:		
Leasehold improvements	980	980
Computer equipment	2,686	2,545
Furniture and fixtures	461	461
Total property and equipment	4,127	3,986
Less accumulated depreciation	2,936	2,670
Net property and equipment	1,191	1,316
Other assets:		
Goodwill	7,576	7,576
Other intangibles, net of amortization of $48 and $35	83	30
Total assets	$ 16,223	$ 16,173
Liabilities and stockholders equity		
Current liabilities:		
Revolving line of credit	$	$ 300
Accounts payable	782	636
Accrued liabilities	821	1,047
Unearned revenue	4,889	5,272
Current portion of notes payable	330	316
Current portion of capital lease obligations	3	24
Total current liabilities	6,825	7,595
Long-term portion of notes payable	1,391	557
Other liabilities	128	170
Deferred tax liability	1,370	1,250
Total liabilities	9,714	9,572
Stockholders equity:		
Preferred stock, $.01 par value, authorized 500,000 shares; none issued and outstanding		
5% preferred stock, Series B, voting, cumulative, convertible, $.01 par value (liquidation preference at par), authorized 1,000,000 shares, none issued and outstanding		
	362	362

Common stock, $.01 par value, authorized 10,000,000 shares; 3,627,931 and 3,619,638 shares issued and 3,615,215 and 3,606,922 shares outstanding		
Additional paid-in capital	185,349	184,990
Accumulated deficit	(179,007)	(178,556)
Receivable for common stock issued	(26)	(26)
Treasury stock, at cost, 12,716 shares	(169)	(169)
Total stockholders equity	6,509	6,601
Total liabilities and stockholders equity	$ 16,223	$ 16,173

See accompanying notes to the condensed consolidated financial statements

Table of Contents

Sonic Foundry, Inc.

Condensed Consolidated Statements of Operations

(in thousands, except for share and per share data)

(Unaudited)

	Three Months Ended March 31,		Six Months Ended March 31,	
	2010	2009 (Revised)	2010	2009 (Revised)
Revenue:				
Product	$ 2,509	$ 3,249	$ 4,437	$ 4,993
Services	2,366	2,129	4,914	4,365
Other	34	35	60	64
Total revenue	4,909	5,413	9,411	9,422
Cost of revenue:				
Product	1,114	1,195	1,944	1,961
Services	119	135	309	260
Total cost of revenue	1,233	1,330	2,253	2,221
Gross margin	3,676	4,083	7,158	7,201
Operating expenses:				
Selling and marketing	2,320	2,607	4,538	5,270
General and administrative	594	733	1,397	1,516
Product development	805	887	1,516	1,790
Total operating expenses	3,719	4,227	7,451	8,576
Loss from operations	(43)	(144)	(293)	(1,375)
Other expense, net	(28)	(8)	(38)	(17)
Loss before income taxes	(71)	(152)	(331)	(1,392)
Provision for income taxes	(60)	(36)	(120)	(72)
Net loss	$ (131)	$ (188)	$ (451)	$ (1,464)
Net loss per common share: basic and diluted	$ (0.04)	$ (0.05)	$ (0.12)	$ (0.41)
Weighted average common shares basic and diluted	3,614,321	3,581,441	3,610,581	3,578,193

See accompanying notes to the condensed consolidated financial statements

Table of Contents

Sonic Foundry, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	Six months ended March 31,	
	2010	**2009 (Revised)**
Operating activities		
Net loss	$ (451)	$ (1,464)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of other intangibles	18	7
Depreciation and amortization of property and equipment	266	327
Other non-cash items		(3)
Deferred taxes	120	72
Share-based compensation expense related to stock warrants and options	63	368
Provision for doubtful accounts		(45)
Changes in operating assets and liabilities:		
Accounts receivable	(222)	(103)
Inventories	332	202
Prepaid expenses and other current assets	33	(309)
Accounts payable and accrued liabilities	(80)	(507)
Other long-term liabilities	(42)	(42)
Unearned revenue	(383)	64
Net cash used in operating activities	(346)	(1,433)
Investing activities		
Purchases of property and equipment	(141)	(178)
Net cash used in investing activities	(141)	(178)
Financing activities		
Net proceeds from (payments on) line of credit	(300)	600
Proceeds from notes payable	1,250	
Payments on notes payable	(153)	(167)
Payments on debt issuance costs	(66)	
Proceeds from exercise of common stock options	12	85
Proceeds from issuance of common stock	29	55
Payments on capital lease obligations	(20)	(25)
Net cash provided by financing activities	752	548
Net increase (decrease) in cash	265	(1,063)
Cash and cash equivalents at beginning of period	2,598	3,560
Cash and cash equivalents at end of period	$ 2,863	$ 2,497

See accompanying notes to the condensed consolidated financial statements

Table of Contents

Sonic Foundry, Inc.

Notes to Condensed Consolidated Financial Statements

March 31, 2010

(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

Sonic Foundry, Inc. (the Company) is in the business of providing enterprise solutions and services for the web communications market.

Interim Financial Data

The accompanying unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States (GAAP) for complete financial statements and should be read in conjunction with the Company s annual report filed on Form 10-K for the fiscal year ended September 30, 2009. In the opinion of management, all adjustments (consisting only of adjustments of a normal and recurring nature) considered necessary for fair presentation of the results of operations have been included. Operating results for the three and six month periods ended March 31, 2010 are not necessarily indicative of the results that might be expected for the year ending September 30, 2010.

Revenue Recognition

General

Revenue is recognized when persuasive evidence of an arrangement exists, delivery occurs or services are rendered, the sales price is fixed or determinable and collectability is reasonably assured. Revenue is deferred when undelivered products or services are essential to the functionality of delivered products, customer acceptance is uncertain, significant obligations remain, or the fair value of undelivered elements is unknown. The Company does not offer customers the right to return product, other than for exchange or repair pursuant to a warranty or stock rotation. The Company s policy is to reduce revenue if it incurs an obligation for price rebates or other such programs during the period the obligation is reasonably estimated to occur. The following policies apply to the Company s major categories of revenue transactions.

Products

Products are considered delivered, and revenue is recognized, when title and risk of loss have been transferred to the customer. Under the terms and conditions of the sale, this occurs at the time of shipment to the customer. Product revenue currently represents sales of our Mediasite recorder and Mediasite related products such as our server software.

Services

We sell support contracts to our customers, typically one year in length and record the related revenue ratably over the contractual period. Our support contracts cover phone and electronic technical support availability over and above the level provided by our distributors, software upgrades on a when and if available basis, advance hardware replacement and an extension of the standard hardware warranty from 90 days to one year. The manufacturer we contract with to build the units performs hardware warranty service. We also sell installation, training, event webcasting, and customer content hosting services. Revenue for those services is recognized when performed in the case of installation, training and event webcasting services and is recognized ratably over the contract period for content hosting services. Service amounts invoiced to customers in excess of revenue recognized are recorded as deferred revenue until the revenue recognition criteria are met.

Table of Contents

Revenue Arrangements that Include Multiple Elements

Revenue for transactions that include multiple elements such as hardware, software, installation, training, and post customer support is allocated to each element based on vendor-specific objective evidence of the fair value (VSOE) in accordance with FASB ASC-985-605. Revenue is recognized for each element when the revenue recognition criteria have been met for that element. VSOE is based on the price charged when the element is sold separately. If VSOE of fair value does not exist for all elements in a multiple element arrangement, revenue is allocated first to the fair value of the undelivered elements and the residual revenue to the delivered elements. The Company recognizes revenue for delivered elements only when all of the following criteria are satisfied: undelivered elements are not essential to the functionality of delivered elements, uncertainties regarding customer acceptance are resolved, and the fair value for all undelivered elements is known.

Reserves

We record reserves for stock rotations, price adjustments, rebates, and sales incentives to reduce revenue and accounts receivable for these and other credits we may grant to customers. Such reserves are recorded at the time of sale and are calculated based on historical information (such as rates of product stock rotations) and the specific terms of sales programs, taking into account any other known information about likely customer behavior. If actual customer behavior differs from our expectations, additional reserves may be required. Also, if we determine that we can no longer accurately estimate amounts for stock rotations and sales incentives, we would not be able to recognize revenue until resellers sell the inventory to the final end user.

Shipping and Handling

The Company s shipping and handling costs billed to customers are included in other revenue. Costs related to shipping and handling are included in cost of revenue and are recorded at the time of shipment to the customer.

Concentration of Credit Risk and Other Risks and Uncertainties

The Company s cash and cash equivalents are deposited with two major financial institutions. At times, deposits in these institutions exceed the amount of insurance provided on such deposits. The Company has not experienced any losses on such amounts and believes that it is not exposed to any significant credit risk on these balances.

We perform ongoing credit evaluations of our customers financial condition and generally do not require collateral. We maintain allowances for potential credit losses and such losses have been within our expectations.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Inventory Valuation

Inventory consists of raw materials and supplies used in the assembly of Mediasite units and finished Mediasite units. Inventory of completed Mediasite units and spare parts are carried at the lower of cost or market, with cost determined on a first-in, first-out basis. Inventory consists of the following (in thousands):

	3/31/10	9/30/09
Raw materials and supplies	$ 10	$ 10
Finished goods	98	430
	$ 108	$ 440

Fair Value of Financial Instruments

The Company s financial instruments consist primarily of cash and cash equivalents, accounts receivable, accounts payable and debt instruments. The book values of cash and cash equivalents, accounts receivable, debt and accounts payable are considered to be representative of their respective fair values. The carrying value of capital lease obligations, including the current portion, approximates fair market value as the fixed rate approximates the current market rate of interest available to the Company.

Stock Based Compensation

On March 5, 2009, Stockholders approved adoption of the 2009 Stock Incentive Plan (the 2009 Plan) which provides for issuance of options to purchase up to 400,000 shares of common stock. The 2009 Plan replaced both a qualified stock option plan and a non-qualified stock option plan which expired on October 1, 2009. The Company also maintains a directors stock option plan under which options may be issued to purchase up to an aggregate of 50,000 shares of common stock. Each non-employee director, who is re-elected or who continues as a member of the board of directors on each annual meeting date and on each subsequent meeting of Stockholders, will be granted options to purchase 2,000 shares of common stock under the directors plan, or at other times or amounts at the discretion of the Board of Directors.

Each option entitles the holder to purchase one share of common stock at the specified option price. The exercise price of each option granted under the plans was set at the fair market value of the Company s common stock at the respective grant date. Options vest at various intervals and expire at the earlier of termination of employment, discontinuance of service on the board of directors, ten years from the grant date or at such times as are set by the Company at the date of grant.

Compensation cost for options will be recognized in earnings, net of estimated forfeitures, on a straight-line basis over the requisite service period. There were no capitalized stock-based compensation costs at March 31, 2010.

The Company uses a lattice valuation model to account for all stock options granted subsequent to September 30, 2005. The lattice valuation model is a more flexible analysis to value options because of its ability to incorporate inputs that change over time, such as actual exercise behavior of option holders. The Company uses historical data to estimate the option exercise and employee departure behavior in the lattice valuation model. Expected volatility is based on historical volatility of the Company s stock. The Company considers all employees to have similar exercise behavior and therefore has not identified separate homogenous groups for valuation. The expected term of options granted is derived from the output of the option pricing model and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods the options are expected to be outstanding is based on the U.S. Treasury yields in effect at the time of grant.

The fair value of each option grant is estimated using the assumptions in the following table:

	Three months ended March 31,	
	2010	**2009**
Expected life	4.9 years	6.0 years
Risk-free interest rate	1.38%	1.36%
Expected volatility	86.90%	85.79%
Expected dividend yield	0%	0%

Table of Contents

A summary of option activity as of March 31, 2010 and changes during the six months then ended is presented below:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Period	Aggregate Intrinsic Value
Outstanding at October 1, 2009	766,615	$ 16.20	6.5	$ 91,499
Granted	41,450	5.68	9.8	
Exercised	(2,399)	5.30	8.8	380
Forfeited	(33,505)	122.72	5.7	12,974
Outstanding at March 31, 2010	772,161	11.03	6.2	546,466
Exercisable at March 31, 2010	516,542	$ 12.93	4.8	$ 232,824

A summary of the status of the Company s non-vested shares and changes during the six month periods ended March 31, 2010 and 2009 are presented below:

	2010		2009	
Non-vested Shares	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Non-vested at October 1,	301,015	$ 5.13	197,244	$ 7.70
Granted	40,950	3.50	120,049	3.30
Vested	(72,689)	7.06	(93,343)	5.70
Forfeited	(12,894)	5.20	(6,033)	8.80
Non-vested at March 31,	256,382	$ 4.33	217,917	$ 5.90

The weighted average grant date fair value of options granted during the six months ended March 31, 2010 was $3.50. As of March 31, 2010, there was $591 thousand of total unrecognized compensation cost related to non-vested share-based compensation, net of $138 thousand of estimated forfeitures. The cost is expected to be recognized over a weighted-average remaining life of 1.9 years.

Stock-based compensation recorded in the three month period ended March 31, 2010 of $139 thousand was allocated $93 thousand to selling and marketing expenses, $10 thousand to general and administrative expenses, and $36 thousand to product development expenses. Stock-based compensation recorded in the six month period ended March 31, 2010 of $63 thousand was allocated $43 thousand to selling and marketing expenses, $5 thousand to general and administrative expenses, and $15 thousand to product development expenses. Cash received from option exercises under all stock option plans for the three and six month periods ended March 31, 2010 was $13 thousand. Cash received from option exercises under all stock option plans for the three and six month periods ended March 31, 2009 was $73 thousand and $87 thousand, respectively. There were no tax benefits realized for tax deductions from option exercises in either of the six month periods ended March 31, 2010 or 2009. The Company currently expects to satisfy share-based awards with registered shares available to be issued.

The Company also has an Employee Stock Purchase Plan (Purchase Plan) under which an aggregate of 50,000 common shares may be issued. All employees who have completed 90 days of employment with the company on the first day of each offering period are eligible to participate in the Purchase Plan. An employee who, after the grant of an option to purchase, would hold common stock and/or hold outstanding options to purchase stock possessing 5% or more of the total combined voting power or value of the company will not be eligible to participate. Eligible employees may make contributions through payroll deductions of up to 10% of their compensation. No participant in the Purchase Plan is permitted to purchase common stock under the Purchase Plan if such option would permit his or her rights to purchase stock under the Purchase Plan to accrue at a rate that exceeds $25,000 of the fair market value of such shares, or that exceeds 1,000 shares, for each calendar year. The company makes a bi-annual offering

9

to eligible employees of options to purchase shares of common stock under the Purchase Plan on the first trading day of January and July. Each offering period is for a period of six months from the date of the offering, and each eligible employee as of the date of offering is entitled to purchase shares of common stock at a purchase price equal to the lower of 85% of the fair market value of common stock on the first or last trading day of the offering period. There were 5,894 shares purchased by employees for the six month offering ended December 31, 2009 which were issued January 2010. A total of 15,862 shares are available to be issued under the plan.

Per share computation

Basic and diluted net loss per share information for all periods is presented under the requirements of FASB ASC-260-10. Basic earnings (loss) per share has been computed using the weighted-average number of shares of common stock outstanding during the period, less shares that may be repurchased, and excludes any dilutive effects of options and warrants. If the Company had reported net income during the periods presented below, diluted net income per share would have been computed using common equivalent shares related to outstanding options and warrants to purchase common stock. The numerator for the calculation of basic and diluted earnings per share is net income (loss). The following table sets forth the computation of basic and diluted weighted average shares used in the earnings per share calculations:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2010	**2009**	**2010**	**2009**
Denominator				
Denominator for basic earnings per share weighted average common shares	3,614,321	3,581,441	3,610,581	3,578,193
Effect of dilutive options and warrants (treasury method)				
Denominator for diluted earnings per share adjusted weighted average common shares	3,614,321	3,581,441	3,610,581	3,578,193
Options and warrants outstanding during each period, but not included in the computation of diluted earnings per share because they are antidilutive	865,485	756,731	865,485	756,731

New Accounting Pronouncements

In April 2009, the FASB issued guidance concerning interim disclosures about fair value of financial instruments requiring publicly traded companies to provide disclosure about the fair value of financial instruments whenever interim summarized financial information is reported. Previously, disclosures about the fair value of financial instruments were only required on an annual basis. Disclosure shall include the method(s) and significant assumptions used to estimate the fair value of financial instruments and shall describe changes in method(s) and significant assumptions, if any, during the period. This guidance was effective for interim and annual periods ending after June 15, 2009, and, as such, the Company began including this disclosure with its third quarter 2009 financial statements.

In October 2009, the FASB issued Accounting Standards Update 2009-13, *Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements* (ASU 2009-13) and ASU 2009-14, *Software (Topic 985) Certain Revenue Arrangements That Include Software Elements* (ASU 2009-14). ASU 2009-13 modifies the requirements that must be met for an entity to recognize revenue from the sale of a delivered item that is part of a multiple-element arrangement when other items have not yet been delivered. ASU 2009-13 eliminates the requirement that all undelivered elements must have either: (i) vendor-specific objective evidence, or VSOE , or

(ii) third-party evidence, or TPE , before an entity can recognize the portion of an overall arrangement consideration that is attributable to items that already have been delivered. In the absence of VSOE or TPE of the standalone selling price for one or more delivered or undelivered elements in a multiple-element arrangement, entities will be required to estimate the selling prices of those elements. Overall arrangement consideration will be allocated to each element (both delivered and undelivered items) based on their relative selling prices, regardless of whether those selling prices are evidenced by VSOE or TPE or are based on the entity s estimated selling price. The residual method of allocating arrangement consideration has been eliminated. ASU 2009-14 modifies the software revenue recognition guidance to exclude from its scope tangible products that contain both software and non-software components that function together to deliver a product s essential functionality. These new updates are effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. An entity may elect retrospective application to all revenue arrangements for all periods presented. Entities must adopt the amendments resulting from both of these ASUs in the same period using the same transition method, where applicable. The Company is currently evaluating the impact that the adoption of these ASUs will have on our consolidated financial statements.

2. Prior Year Revisions

During 2009, the Company identified an issue requiring revision of the prior period financial statements relating to the presentation of disclosure of Deferred Tax Liabilities. Beginning with an acquisition in fiscal year 2002, the Company has amortized Goodwill for tax purposes over a 15 year life. Goodwill is not amortized for book purposes. Annual impairment tests are performed for book purposes and the balance of goodwill is to be written down if impairment occurs. The impairment tests have not indicated any goodwill impairment.

The difference between the book and tax balance of Goodwill creates a Deferred Tax Liability and an annual tax expense. Because of the long term nature of the goodwill timing difference, tax planning strategies cannot be applied related to the Deferred Tax Liability. The balance of the Deferred Tax Liability at September 30, 2008 was $1.1 million. This amount was disclosed in the footnotes but was omitted from the consolidated balance sheet. Management incorrectly netted the amount with the $36 million Deferred Tax Assets, which are also disclosed in the footnotes but not recorded on the consolidated balance sheet. Because of the long-term nature of the goodwill timing difference, these amounts cannot be netted.

Management has deemed this to be not material in the prior periods presented; however, management has elected to revise the statements under the guidance of SEC SAB 108 as the difference between book and tax goodwill, i.e., the Deferred Tax Liability, will continue to increase and could become material in future periods.

Management correctly recorded the Deferred Tax Liability and corresponding expense in fiscal year 2009 and corrected prior year amounts on the financial statements and disclosures beginning with this fiscal year 2009 10-K filing.

Table of Contents

The following table discloses selected Q2-2009 financial information as originally presented and as revised.

Statement of Operations (in thousands except share and per share data)	Three Months Ended March 31, 2009		
	As Presented	Adjustments	Revised
Provision for income taxes	$	$ (36)	$ (36)
Net loss	$ (152)	$ (36)	$ (188)
Loss per common share:			
Basic net loss per common share	$ (0.04)	$ (0.01)	$ (0.05)
Diluted net loss per common share	$ (0.04)	$ (0.01)	$ (0.05)

	Six Months Ended March 31, 2009		
	As Presented	Adjustments	Revised
Provision for income taxes	$	$ (72)	$ (72)
Net loss	$ (1,392)	$ (72)	$ (1,464)
Loss per common share:			
Basic net loss per common share	$ (0.39)	$ (0.02)	$ (0.41)
Diluted net loss per common share	$ (0.39)	$ (0.02)	$ (0.41)

Statement of Cash Flows (in thousands)	Six Months Ended March 31, 2009		
	As Presented	Adjustments	Revised
Provision for income taxes	$	$ 72	$ 72

3. Related Party Transactions

During the three and six month periods ended March 31, 2010, the Company incurred fees of $65 thousand and $130 thousand, respectively, to a law firm, a partner of which is a director and stockholder of the Company. The Company incurred similar fees of $70 and $133 thousand, respectively, during the three and six month periods ended March 31, 2009. The Company had accrued liabilities for unbilled services of $40 thousand at March 31, 2010 and $19 thousand at September 30, 2009, respectively, to the same law firm.

During the three and six month periods ended March 31, 2010, the Company recorded Mediasite product and customer support revenue related to $237 thousand and $373 thousand, respectively, of billings to Mediasite KK, a Japanese reseller in which the Company has an equity interest. The Company recorded billings of $234 and $388 thousand, respectively, in the three and six month periods ended March 31, 2009. Mediasite KK owed the Company $238 thousand on billings at March 31, 2010 and $128 thousand on billings at September 30, 2009. The Company accounts for its investment in Mediasite KK under the equity method. The recorded value as of March 31, 2010 and September 30, 2009 is zero.

Table of Contents

As of March 31, 2010 and September 30, 2009, the Company had a loan outstanding to an executive totaling $26 thousand. This loan is secured by company stock.

4. Purchase Commitments

The Company enters into unconditional purchase commitments on a regular basis for the supply of Mediasite product. As of March 31, 2010, the Company has an obligation to purchase a remaining $693 thousand, which is not recorded on the Company s Consolidated Balance Sheet.

5. Borrowing Arrangements

Silicon Valley Bank

On June 16, 2008, the Company and its wholly-owned subsidiary, Sonic Foundry Media Systems, Inc. (collectively, the Companies) entered into an Amended and Restated Loan and Security Agreement (the Amended Loan Agreement) with Silicon Valley Bank providing for a credit facility in the form of a $3,000,000 secured revolving line of credit and a $1,000,000 term loan. The ability to borrow up to the maximum $3,000,000 amount of the revolving line of credit is determined by applying an applicable percentage to eligible accounts receivable, which, is reduced by, among other things, a reserve. Prior to the First Amendment, discussed below, the reserve was equal to the balance of the term loan when EBITDA, as defined, would have been less than $200,000 during the preceding six month period. The revolving line of credit accrues interest at a per annum rate equal to the following: (i) during such period that Sonic Foundry maintains an Adjusted Quick Ratio (as defined) of greater than 2.00 to 1.00, the greater of one percentage point (1.0%) above Silicon Valley s prime rate, or seven percent (7.0%); or (ii) during such period that Sonic Foundry maintains an Adjusted Quick Ratio equal to or less than 2.00 to 1.00, the greater of one and one-half percent (1.5%) above Silicon Valley s prime rate, or seven and one-half percent (7.5%). Under the Amended Agreement, the term loan will continue to accrue interest at a per annum rate equal to the greater of (i) one percentage point (1.0%) above Silicon Valley s prime rate; or (ii) eight and three quarters percent (8.75%). Prior to the First Amendment, the maturity of both the term loan and the revolving line of credit was June 1, 2010. At the maturity date all outstanding borrowings and any unpaid interest thereon must be repaid, and all outstanding letters of credit must be cash collateralized. Principal on the term loan is to be repaid in thirty-six (36) monthly installments, and prior to the First Amendment, was to be repaid in full on May 1, 2010.

The Amended Loan Agreement contains certain financial covenants, including a covenant requiring the Companies to maintain certain of their depository, operating and securities accounts with Silicon Valley Bank, and a covenant relating to EBITDA (EBITDA Covenant); however, the EBITDA Covenant will not have to be satisfied provided that Sonic Foundry maintains an Adjusted Quick Ratio (as defined) greater than or equal to 1.75 to 1.00. The Amended Loan Agreement also contains certain other restrictive loan covenants, including covenants limiting the Companies ability to dispose of assets, make acquisitions, be acquired, incur indebtedness, grant liens, make investments, pay dividends, and repurchase stock. At March 31, 2010 the Company was in compliance with all covenants in the Amended Loan Agreement, as amended by the First Amendment to the Amended and Restated Loan Agreement (First Amendment).

The Amended Loan Agreement contains events of default that include, among others, non-payment of principal or interest, inaccuracy of any representation or warranty, violation of covenants, bankruptcy and insolvency events, material judgments, cross defaults to certain other indebtedness, and material adverse changes. The occurrence of an event of default could result in the acceleration of the Companies obligations under the Amended Loan Agreement.

Pursuant to the Amended Loan Agreement, the Company and its wholly-owned subsidiary pledged as collateral to the Bank substantially all non-intellectual property business assets, and entered into an Intellectual Property Security Agreement with respect to intellectual property assets.

On April 14, 2009, the Company executed the First Amendment with Silicon Valley Bank. The First Amendment, among other things, a) refinances the $361,111 outstanding balance of the Term Loan with a new Term Loan 2 in the amount of $1,000,000, due in 36 equal monthly installments of principal and interest; b) modifies the method of

determining the requirement for a reserve under the Revolving Line for the balance of the term loan to require a reserve unless, for three (3) consecutive monthly periods, the ratio of EBITDA to Debt Service, in each case for the three (3) month period then ending is greater than or equal to 1.25 to 1.00; c) modifies the minimum requirements under the EBITDA covenant, but maintains the provision to override such covenant if the Company maintains a minimum Quick Ratio of 1.75 to 1.00; and d) extends the maturity date of the Revolving Line to October 1, 2011 and the Term Loan 2 to April 1, 2012. At March 31, 2010, a balance of $746 thousand was remaining on the term loan and no balance was outstanding on the revolving line of credit. At March 31, 2010, there was $1.6 million available under this credit facility for advances.

Partners for Growth

On March 5, 2010, Sonic Foundry, Inc., and its wholly-owned subsidiary, Sonic Foundry Media Systems, Inc. (SFMS) executed the $1,250,000 Loan and Security Agreement (the Term Loan) and the $750,000 Revolving Loan and Security Agreement (the Revolver) with Partners for Growth II, L.P. (PFG), (collectively the Agreements).

The Term Loan bears interest at 11.75% per annum with principal due in 36 equal monthly payments of $34,722.22 beginning April 1, 2011 and continuing through March 1, 2014 unless the combination of the Company s cash and availability falls below certain levels, at which point the principal will be due in equal payments over the remaining months left in the period ending 36 months from the date of the Term Loan.

The Revolving Loan bears interest at the Prime Rate from time to time, plus 6.5% per annum. The Revolving Loan was available to the Company if the Company exceeded 90% of certain Revenue and EBITDA targets for the quarters ending December 31, 2009 and March 31, 2010. While the Company achieved its revenue targets for each of the quarters, achieved the EBITDA target for the quarter ended December 31, 2009 and recorded positive EBITDA for the quarter ended March 31, 2010, it failed to reach the target necessary to draw on the Revolving Loan. The Company believes it has sufficient liquidity available to support its operations for at least the next twelve months without use of the Revolving Loan.

Each of the Agreements is collateralized by substantially all the Company s assets, including intellectual property, subject to a first lien held by Silicon Valley Bank, requires compliance with an adjusted quick ratio covenant of 1.75:1.00 and required payment of a fee equal to $15,000 at close. As of March 31, 2010, the Company was in compliance with this covenant.

Coincident with execution of the Agreements, the Company entered into a Warrant Purchase Agreement (Purchase Agreement) and a Warrant Agreement (Warrant) with PFG. Pursuant to the terms of the Purchase Agreement, PFG purchased a warrant to purchase up to 76,923 shares of common stock of the Company at an exercise price of $6.25 per share, subject to certain adjustments, for a purchase price of $3,333. PFG is entitled to exercise a warrant to purchase 28,846 shares of common stock only if the Company borrows funds pursuant to the Revolving Loan. The remaining warrant to purchase 48,077 shares of common stock is exercisable at any time. The strike price may be adjusted to the volume-weighted average closing price of the Company s common stock for the 10-trading day period immediately following the Company s release of its results for the fiscal quarter ending June 30, 2010 if such result is less than $6.25 per share, but in no event less than $5.20 per share.

The Company valued the warrants issued pursuant to the Purchase Agreement using the Black-Scholes method assuming a 1) life of seven years; 2) volatility factor of 86.9%; 3) risk free interest rate of 1.38%, less $3,333 proceeds received from PFG. The resulting $255 thousand value of the warrants is treated as a debt discount and netted against the carrying value of the Term Loan on the balance sheet. The discount is amortized at a constant rate applied to the outstanding balance of the Term Loan with a corresponding increase to non-cash interest expense. At March 31, 2010 the remaining balance of the discount was $250 thousand.

Table of Contents

6. Income Taxes

The Company is subject to taxation in the U.S. and various state jurisdictions. All of the Company s tax years are subject to examination by the U.S. and state tax authorities due to the carryforward of unutilized net operating losses.

Deferred income taxes are provided for temporary differences between financial reporting and income tax basis of assets and liabilities, and are measured using currently enacted tax rates and laws. Deferred income taxes also arise from the future benefits of net operating loss carryforwards. A valuation allowance equal to 100% of the net deferred tax assets has been recognized due to uncertainty regarding future realization.

Beginning with an acquisition in fiscal year 2002, the Company has amortized Goodwill for tax purposes over a 15 year life. Goodwill is not amortized for book purposes. Annual impairment tests are performed for book purposes and the balance of goodwill is to be written down if impairment occurs. The impairment tests have not indicated any goodwill impairment.

The difference between the book and tax balance of Goodwill creates a Deferred Tax Liability and an annual tax expense. Because of the long term nature of the goodwill timing difference, tax planning strategies cannot be applied related to the Deferred Tax Liability. The balance of the Deferred Tax Liability at March 31, 2010 was $1.39 million and at September 30, 2009 was $1.25 million.

The Company s practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company had no accruals for interest and penalties on the Company s Consolidated Balance Sheets at September 30, 2009 or March 31, 2010, and has not recognized any interest or penalties in the Consolidated Statements of Operations for either of the three or six month periods ended March 31, 2010 or 2009.

7. Reverse Stock Split

The Company completed a one-for-ten reverse split of its stock effective at the end of trading on November 16, 2009. The number of shares of Sonic Foundry common stock issued and outstanding have been reduced from approximately 36,069,000 shares to approximately 3,606,900 shares post-split, without accounting for the payout on fractional shares. This reverse stock split has been reflected in the share and per share data presented throughout this report.

Table of Contents

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
Risks and Uncertainties

The following discussion of the consolidated financial position and results of operations of the Company should be read in conjunction with the consolidated financial statements and notes thereto included elsewhere in this form 10-Q and the Company s annual report filed on form 10-K for the fiscal year ended September 30, 2009. In addition to historical information, this discussion contains forward-looking statements such as statements of the Company s expectations, plans, objectives and beliefs. These statements use such words as may, will, expect, anticipate, believe, plan, and other similar terminology.

Actual results could differ materially from expectations due to changes in the market acceptance of our products, competition, market introduction or product development delays; all of which would impact our strategy to develop a network of inside regional sales managers and distribution partners that target customer opportunities for multi-unit and repeat purchases. If the Company does not achieve multi-unit and repeat purchases, our business will be harmed.

Uncertainty about current global economic conditions poses a risk as businesses, educational institutions and state governments are likely to postpone spending in response to tighter credit, negative financial news and/or declines in income or asset values. Most of our customers and potential customers are public colleges, universities, schools and other education providers who depend substantially on government funding. Many state governments are under substantial budget constraints and will likely reduce spending for education providers, without Federal government support. Proposed federal government support for education may not be approved or, if approved, may not succeed in eliminating reductions in spending for our products and services.

Other factors that may impact actual results include: our ability to effectively integrate acquired businesses, length of time necessary to close on sales leads to multi-unit purchasers, our ability to service existing accounts, global and local business conditions, legislation and governmental regulations, competition, our ability to effectively maintain and update our product portfolio, shifts in technology, political or economic instability in local markets, and currency and exchange rate fluctuations, as well as other issues which may be identified from time to time in Sonic Foundry s Securities and Exchange Commission filings and other public announcements.

Overview

Sonic Foundry, Inc. is a technology leader in the emerging web communications marketplace, providing enterprise solutions and services that link an information-driven world. The company s principal product line, Mediasite® is a web communication and content management system that automatically and cost-effectively webcasts lectures and presentations. Trusted by Fortune 500 companies, top education institutions and Federal, state and local government agencies for a variety of critical communication needs, Mediasite is the leading one-to-many multimedia communication solution for capturing knowledge and sharing it online.

New Accounting Pronouncements

In April 2009, the FASB issued guidance concerning interim disclosures about fair value of financial instruments requiring publicly traded companies to provide disclosure about the fair value of financial instruments whenever interim summarized financial information is reported. Previously, disclosures about the fair value of financial instruments were only required on an annual basis. Disclosure shall include the method(s) and significant assumptions used to estimate the fair value of financial instruments and shall describe changes in method(s) and significant assumptions, if any, during the period. This guidance was effective for interim and annual periods ending after June 15, 2009, and, as such, the Company began including this disclosure with its third quarter 2009 financial statements.

In October 2009, the FASB issued Accounting Standards Update 2009-13, *Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements* (ASU 2009-13) and ASU 2009-14, *Software (Topic 985) Certain Revenue Arrangements That Include Software Elements* (ASU 2009-14). ASU 2009-13 modifies the

Table of Contents

requirements that must be met for an entity to recognize revenue from the sale of a delivered item that is part of a multiple-element arrangement when other items have not yet been delivered. ASU 2009-13 eliminates the requirement that all undelivered elements must have either: (i) vendor-specific objective evidence, or VSOE , or (ii) third-party evidence, or TPE , before an entity can recognize the portion of an overall arrangement consideration that is attributable to items that already have been delivered. In the absence of VSOE or TPE of the standalone selling price for one or more delivered or undelivered elements in a multiple-element arrangement, entities will be required to estimate the selling prices of those elements. Overall arrangement consideration will be allocated to each element (both delivered and undelivered items) based on their relative selling prices, regardless of whether those selling prices are evidenced by VSOE or TPE or are based on the entity s estimated selling price. The residual method of allocating arrangement consideration has been eliminated. ASU 2009-14 modifies the software revenue recognition guidance to exclude from its scope tangible products that contain both software and non-software components that function together to deliver a product s essential functionality. These new updates are effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. An entity may elect retrospective application to all revenue arrangements for all periods presented. Entities must adopt the amendments resulting from both of these ASUs in the same period using the same transition method, where applicable. The Company is currently evaluating the impact that the adoption of these ASUs will have on our consolidated financial statements.

Critical Accounting Policies

We have identified the following as critical accounting policies to our Company and have discussed the development, selection of estimates and the disclosure regarding them with the audit committee of the board of directors:

Revenue recognition, allowance for doubtful accounts and reserves;

Impairment of long-lived assets;

Valuation allowance for net deferred tax assets; and

Accounting for stock-based compensation.

Revenue Recognition, Allowance for Doubtful Accounts and Reserves

General

Revenue is recognized when persuasive evidence of an arrangement exists, delivery occurs or services are rendered, the sales price is fixed or determinable and collectability is reasonably assured. Revenue is deferred when undelivered products or services are essential to the functionality of delivered products, customer acceptance is uncertain, significant obligations remain, or the fair value of undelivered elements is unknown. The Company does not offer customers the right to return product, other than for exchange or repair pursuant to a warranty or stock rotation. The Company s policy is to reduce revenue if it incurs an obligation for price rebates or other such programs during the period the obligation is reasonably estimated to occur. The following policies apply to the Company s major categories of revenue transactions.

Products

Products are considered delivered, and revenue is recognized, when title and risk of loss have been transferred to the customer. Under the terms and conditions of the sale, this occurs at the time of shipment to the customer. Product revenue currently represents sales of our Mediasite recorders and Mediasite related products such as our server software.

Services

We sell support contracts to our customers, typically one year in length, and record the related revenue ratably over the contractual period. Our support contracts cover phone and electronic technical support availability over and above the level provided by our distribution partners, software upgrades on a when and if available basis, advance hardware replacement and an extension of the standard hardware warranty from 90 days to one year. The manufacturers we contract with to build the units provide a limited one-year warranty on the hardware. We also sell

17

installation, training, event webcasting, and customer content hosting services. Revenue for those services is recognized when performed in the case of installation, training and event webcasting services and is recognized ratably over the contract period for content hosting services. Service amounts invoiced to customers in excess of revenue recognized are recorded as deferred revenue until the revenue recognition criteria are met.

Revenue Arrangements that Include Multiple Elements

Revenue for transactions that include multiple elements such as hardware, software, installation, training, and post customer support is allocated to each element based on vendor-specific objective evidence of the fair value VSOE in accordance with FASB ASC-985-605. Revenue is recognized for each element when the revenue recognition criteria have been met for that element. VSOE is based on the price charged when the element is sold separately. If VSOE of fair value does not exist for all elements in a multiple element arrangement, revenue is allocated first to the fair value of the undelivered elements and the residual revenue to the delivered elements. The Company recognizes revenue for delivered elements only when all of the following criteria are satisfied: undelivered elements are not essential to the functionality of delivered elements, uncertainties regarding customer acceptance are resolved, and the fair value for all undelivered elements is known.

Reserves

We record reserves for stock rotations, price adjustments, rebates, and sales incentives to reduce revenue and accounts receivable for these and other credits we may grant to customers. Such reserves are recorded at the time of sale and are calculated based on historical information (such as rates of product stock rotations) and the specific terms of sales programs, taking into account any other known information about likely customer behavior. If actual customer behavior differs from our expectations, additional reserves may be required. Also, if we determine that we can no longer accurately estimate amounts for stock rotations and sales incentives, we would not be able to recognize revenue until the customers exercise their rights, or such rights lapse, whichever is later.

Credit Evaluation and Allowance for Doubtful Accounts

We perform ongoing credit evaluations of our customers financial condition and generally do not require collateral. We maintain allowances for potential credit losses and such losses have been within our expectations.

Impairment of long-lived assets

We assess the impairment of goodwill and capitalized software development costs on an annual basis or whenever events or changes in circumstances indicate that the fair value of these assets is less than the carrying value.

If we determine that the fair value of goodwill is less than its carrying value, based upon the annual test or the existence of one or more indicators of impairment, we would then measure impairment based on a comparison of the implied fair value of goodwill with the carrying amount of goodwill. To the extent the carrying amount of goodwill is greater than the implied fair value of goodwill, we would record an impairment charge for the difference.

We evaluate all of our long-lived assets, including intangible assets other than goodwill, for impairment in accordance with the provisions of FASB ASC-360-10. We evaluate all of our long-lived assets and intangible assets, including intangible assets other than goodwill, for impairment. Long-lived assets and intangible assets other than goodwill are evaluated for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on expected undiscounted cash flows attributable to that asset. Should events indicate that any of our long-lived assets are impaired; the amount of such impairment will be measured as the difference between the carrying value and the fair value of the impaired asset and recorded in earnings during the period of such impairment.

Valuation allowance for net deferred tax assets

Deferred income taxes are provided for temporary differences between financial reporting and income tax basis of assets and liabilities, and are measured using currently enacted tax rates and laws. Deferred income taxes also arise from the future benefits of net operating loss carryforwards. A valuation allowance equal to 100% of the net deferred tax assets has been recognized due to uncertainty regarding future realization.

Table of Contents

Accounting for stock-based compensation

Upon the adoption of FASB ASC-718, the Company changed its option valuation model from the Black-Scholes model to a lattice valuation model for all stock options granted subsequent to September 30, 2005. The lattice valuation model is a more flexible analysis to value employee options because of its ability to incorporate inputs that change over time, such as actual exercise behavior of option holders. The Company used historical data to estimate the option exercise and employee departure behavior used in the lattice valuation model. Expected volatility is based on historical volatility of the Company s stock. The Company uses historical data to estimate option exercise and employee termination within the valuation model. The Company considers all employees to have similar exercise behavior and therefore has not identified separate homogenous groups for valuation. The expected term of options granted is derived from the output of the option pricing model and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual term of the options is based on the U.S. Treasury yields in effect at the time of grant. Forfeitures are based on actual behavior patterns.

Results of Continuing Operations

Revenue

Revenue from our business include the sales of Mediasite recorders and server software products and related services contracts, such as customer support, installation, training, content hosting and event services sold separately. We market our products to educational institutions, corporations and government agencies that need to deploy, manage, index and distribute video content on Internet-based networks. We reach both our domestic and international markets through reseller networks, a direct sales effort and partnerships with system integrators.

Q2-2010 compared to Q2-2009

Revenue in Q2-2010 decreased $504 thousand, or 9% from Q2-2009 revenue of $5.4 million to $4.9 million. Revenue consisted of the following:

Product revenue from sale of Mediasite capture units

	Q2-2010	Q2-2009
Units sold	237	279
Rack to mobile ratio	1.5 to 1	1.7 to 1
Average sales price, excluding service (000 s)	$ 9.6	$ 10.3

Services revenue represents the portion of fees charged for Mediasite customer support contracts amortized over the length of the contract, typically 12 months, as well as training, installation, rental, event and content hosting services. Services revenue increased from $2.1 million in Q2-2009 to $2.4 million in Q2-2010 primarily due to an increase in support contracts on new Mediasite capture units and renewals of support contracts entered into in prior years. At March 31, 2010 $4.9 million of unrecognized support and service revenue remained in unearned revenues, of which we expect to realize approximately $2.0 million in the upcoming quarter.

Other revenue relates to freight charges billed separately to our customers.

YTD-2010 (six months) compared to YTD-2009 (six months)

Revenues for YTD-2010 totaled $9.4 million compared to YTD-2009 revenues of $9.4 million. Revenues included the following:

$4.4 million product revenue from the sale of 432 Mediasite recorders and software versus $5.0 million from the sale of 462 Mediasite recorders and software in 2008.

$4.9 million from Mediasite customer support contracts, installation ,training, event and hosting services versus $4.4 million in 2009.

Table of Contents

Gross Margin

Total gross margin for Q2-2010 was $3.7 million for a gross margin percentage of 75% compared to Q2-2009 of $4.1 million or 75%. The significant components of cost of revenue include:

Material and freight costs for the Mediasite recorders. Costs for Q2-2010 Mediasite recorder hardware and other costs totaled $847 thousand, along with $45 thousand of freight costs, and $222 thousand of labor and allocated costs compared to Q2-2009 Mediasite recorder costs of $994 for hardware, $25 thousand for freight and $176 thousand labor and allocated costs.

Services costs. Staff wages and other costs allocated to cost of service revenues were $119 thousand in Q2-2010 and $135 thousand in Q2-2009, resulting in gross margin on services of 95% in Q2-2010 and 94% in Q2-2009.

Operating Expenses

Selling and Marketing Expenses

Selling and marketing expenses include wages and commissions for sales, marketing and business development personnel, print advertising and various promotional expenses for our products. Timing of these costs may vary greatly depending on introduction of new products and services or entrance into new markets, or participation in major tradeshows.

Q2-2010 compared to Q2-2009

Selling and marketing expenses decreased $287 thousand or 11% from $2.6 million in Q2-2009 to $2.3 million in Q2-2010 resulting primarily from:

Q2-2010 salaries, incentive compensation and benefits were reduced from Q2-2009 by $175 thousand due to adjustments to the incentive compensation plan in 2010 as well as reduced headcount. Our sales and marketing staff decreased from 62 at March 31, 2009 to 59 at March 31, 2010.

Facilities expense allocated to selling and marketing decreased by $72 thousand from Q2-2009 primarily due to reduced program expenditures in fiscal 2010.

YTD-2010 compared to YTD-2009

Selling and marketing expenses decreased $732 thousand or 14% from $5.3 million in YTD-2009 to $4.5 million in YTD-2010. YTD decreases in the major categories include:

YTD-2010 salary and benefits decreased $365 thousand from YTD-2009 due to lower staff levels and adjustments to the incentive compensation plan in fiscal 2010.

YTD-2010 facilities expense allocated to selling and marketing decreased by $436 thousand from YTD-2009 primarily due to reduced program expenditures in fiscal 2010.

We anticipate selling and marketing headcount to remain at approximately this level for the remainder of the fiscal year.

General and Administrative Expenses

General and administrative (G&A) expenses consist of personnel and related costs associated with the facilities, finance, legal, human resource and information technology departments, as well as other expenses not fully allocated to functional areas.

Q2-2010 compared to Q2-2009

G&A expenses decreased $139 thousand or 19% over the prior period from $733 thousand in Q2-2009 to $594 thousand in Q2-2010. Decreased salaries and benefits expense of $170 thousand, associated with reduced headcount and changes made to the Company s benefit plan, was the primary reason for the overall decrease.

Table of Contents

YTD-2010 compared to YTD-2009

G&A decreased $119 thousand or 8% from $1.5 million in YTD-2009 to $1.4 million in YTD-2010. The decrease is primarily due to a decrease in salaries and benefits associated with headcount reductions and changes made to the Company s benefit plan.

As of March 31, 2010 we had 6 employees in G&A compared to 9 as of March 31, 2009. We anticipate G&A headcount to remain at or near this level for the remainder of the fiscal year.

Product Development Expenses

Product development expenses include salaries and wages of the software research and development staff and an allocation of benefits, facility and administrative expenses.

Q2-2010 compared to Q2-2009

Product development expenses decreased $82 thousand, or 9% from $887 thousand in Q2-2009 to $805 thousand in Q2-2010. Some significant differences between the periods include:

- Decreased compensation and benefits of $24 thousand due to headcount reduction.
- Decreased facilities expense allocated to product development of $30 thousand.
- Decreased professional services of $18 thousand.

YTD-2010 compared to YTD-2009

YTD-2009 product development expenses decreased $274 thousand, or 15% from YTD-2009. Some significant differences between the periods include:

- Decreased compensation and benefits of $74 thousand
- Decreased facilities expense allocated to product development of $170 thousand
- Decreased professional services of $17 thousand

At March 31, 2010 we had 23 employees, excluding interns, in Product Development compared to 25 employees at March 31, 2009. We anticipate product development headcount to remain flat during the remainder of fiscal 2010. We do not anticipate that any fiscal 2010 software development efforts will qualify for capitalization.

Other Income

Other income is primarily interest income from overnight investment vehicles.

Provisions Related to Income Taxes

On the September 30, 2009, 10-K filing, the Company recorded a non-cash deferred tax liability related to goodwill acquired in 2001 and made corresponding revisions to earlier results. The net impact was to record a $142 thousand non-cash provision for taxes and an increase to a

long-term deferred tax liability of $142 thousand in fiscal 2009 and to record a $256 thousand non-cash provision for taxes in fiscal 2008 as well as the accumulated impact of prior period amortization of goodwill. This liability had historically been presented net of deferred tax assets and associated valuation allowances. Management determined that due to the nature of the deferred tax liability and future growth of such non-cash liability it was more prudent to present separately. Q2-2009 and YTD-2009 numbers have been revised to match this presentation.

Table of Contents

Liquidity and Capital Resources

Cash used in operating activities was $346 thousand in YTD-2010 compared to YTD-2009 of $1.4 million. Cash used in 2010 was impacted by a decrease in the net loss of $1.0 million from $1.5 million to $451 thousand, a partially offsetting decrease in the add-back for non-cash stock compensation from $368 thousand in YTD-2009 to $63 thousand in YTD-2010 and by a reduced need for cash to fund working capital of $333 thousand. Working capital changes included the positive effects of reductions in inventory of $332 thousand and reductions in other current assets of $33 thousand. These were offset by the negative effects of a $383 thousand decrease in unearned revenue and a $222 thousand increase in accounts receivable. YTD-2009 had similar changes in working capital components. Positive effects in YTD-2009 included a reduction in inventory of $202 thousand and an increase in unearned revenue of $64 thousand. Negative effects included a decrease in accounts payable and accrued liabilities of $507 thousand, an increase in accounts receivable of $103 thousand and an increase other current assets of $309 thousand.

Cash used in investing activities was $141 thousand in YTD-2010 compared to a use of $178 thousand in YTD-2009 for the purchase of property and equipment.

Cash provided by financing activities was $752 thousand in YTD-2010 compared to $548 thousand in YTD-2009. These amounts are comprised primarily of cash provided by a new note payable in YTD-2010 and a draw on an existing line of credit in YTD-2009.

The Company believes its cash position is adequate to accomplish its business plan through at least the next twelve months. We may evaluate operating or capital lease opportunities to finance equipment purchases in the future and anticipate utilizing the Company s revolving line of credit to support working capital needs. We may also seek additional equity financing, or issue additional shares previously registered in our available shelf registration, although we currently have no plans to do so.

On March 5, 2010, the Company executed the $1,250,000 Loan and Security Agreement (the Term Loan) with Partners for Growth II. L.P. (PFG). The Term Loan bears interest at 11.75% per annum with principal due in 36 equal monthly payments of $34,722 beginning April 1, 20100 and continuing through March 1, 2014 unless the combination of the Company s cash and availability falls below certain levels, at which point the principal will be due in equal payments over the remaining months left in the period ending 36 months from the date of the Term Loan. Coincident with closing of the Term Loan the Company repaid the outstanding balance of its revolving line of credit with Silicon Valley Bank (SVB). The Company maintains the revolving line of credit with SVB and has $1.6 million available for borrowing at March 31, 2010.

The Company enters into unconditional purchase commitments on a regular basis for the supply of Mediasite product. As of March 31, 2010, the Company has an obligation to purchase a remaining $693 thousand, which is not recorded on the Company s Consolidated Balance Sheet.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
Derivative Financial Instruments

We are not party to any derivative financial instruments or other financial instruments for which the fair value disclosure would be required under FASB ASC-815-10. Our cash equivalents consist of overnight investments in money market funds that are carried at fair value. Accordingly, we believe that the market risk of such investments is minimal.

Interest Rate Risk

Our cash equivalents are subject to interest rate fluctuations, however, we believe this risk is minimal due to the short-term nature of these investments.

Foreign Currency Exchange Rate Risk

All international sales of our products are denominated in US dollars.

ITEM 4. CONTROLS AND PROCEDURES
Evaluation of Disclosure Controls and Procedures

Based on evaluations at March 31, 2010, our principal executive officer and principal financial officer, with the participation of our management team, have concluded that our disclosure controls and procedures (as defined in Rules 13a-15 (e) and 15d-15 (e) under the Securities Exchange Act) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that material information relating to the Company is accumulated and communicated to management, including our principal executive officer and our principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

Changes in Internal Controls

During the period covered by this quarterly report on Form 10-Q, the Company has not made any changes to its internal control over financial reporting (as referred to in Paragraph 4(b) of the Certifications of the Company s principal executive officer and principal financial officer included as exhibits to this report) that have materially affected, or are reasonably likely to affect the Company s internal control over financial reporting.

Table of Contents

PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 1A. RISK FACTORS

There have been no material changes in our risk factors from those disclosed in our Form 10-K for the fiscal year ended September 30, 2009 filed with the SEC.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 5. OTHER INFORMATION

None

Table of Contents

ITEM 6. EXHIBITS

NUMBER	DESCRIPTION
3.1	Amended and Restated Articles of Incorporation of the Registrant, filed as Exhibit No. 3.1 to the registration statement on amendment No. 2 to Form SB-2 dated April 3, 1998 (Reg. No. 333-46005) (the Registration Statement), and hereby incorporated by reference.
3.2	Amended and Restated By-Laws of the Registrant, filed as Exhibit No. 3.1 to Form 8-K filed on December 19, 2007, and hereby incorporated by reference.
10.1*	Registrant s 1995 Stock Option Plan, as amended, filed as Exhibit No. 4.1 to the Registration Statement on Form S-8 on September 8, 2000, and hereby incorporated by reference.
10.2*	Employment Agreement between Registrant and Rimas Buinevicius dated as of January 1, 2001, filed as Exhibit 10.4 to the Quarterly Report on Form 10-Q for the quarter ended December 31, 2000, and hereby incorporated by reference.
10.3*	Employment Agreement between Registrant and Monty R. Schmidt dated as of January 1, 2001, filed as Exhibit 10.5 to the Quarterly Report on Form 10-Q for the quarter ended December 31, 2000, and hereby incorporated by reference.
10.4*	Registrant s Amended 1999 Non-Qualified Plan, filed as Exhibit 4.1 to Form S-8 on December 21, 2001, and hereby incorporated by reference.
10.5	Commercial Lease between West Washington Associates LLC and Sonic Foundry, Inc. regarding 222 West Washington Ave., Suite 775, Madison, WI, dated August 1, 2003 filed as Exhibit 10.21 to Form 10-K filed on December 23, 2003 and hereby incorporated by reference.
10.6	Amendments to Commercial Lease between West Washington Associates LLC and Sonic Foundry, Inc. regarding 222 West Washington Ave., Suite 775, Madison, WI, dated May 17, 2006 and June 5, 2006, filed as exhibit 10.7 to Form 10-K on November 16, 2006, and hereby incorporated by reference.
10.7	Intellectual Property Security Agreement dated May 2, 2007, between Sonic Foundry, Inc. and Silicon Valley Bank filed as Exhibit 10.2 to Form 8-K on May 7, 2007, and hereby incorporated by reference.
10.8	Intellectual Property Security Agreement dated May 2, 2007, between Sonic Foundry Media Systems, Inc. and Silicon Valley Bank filed as Exhibit 10.3 to Form 8-K on May 7, 2007, and hereby incorporated by reference.
10.9*	Employment Agreement dated October 31, 2007 between Sonic Foundry, Inc. and Kenneth A. Minor, filed as Exhibit 10.1 to Form 8-K filed on November 2, 2007, and hereby incorporated by reference.
10.10	Amended and Restated Loan and Security Agreement dated June 16, 2008 and entered into as of June 16, 2008 among registrant, Sonic Foundry Media Services, Inc. and Silicon Valley Bank, filed as exhibit 10.1 to Form 8-K filed on June 20, 2008, and hereby incorporated by reference.
10.11*	Employment Agreement dated August 4, 2008 between Sonic Foundry, Inc. and Robert M. Lipps, filed as Exhibit 10.1 to Form 8-K filed on August 6, 2008, and hereby incorporated by reference.

Table of Contents

10.12	First Amendment to the Amended and Restated Loan and Security Agreement executed as of April 14, 2009 and effective as of April 1, 2009, among registrant, Sonic Foundry Media Systems, Inc. and Silicon Valley Bank, filed as exhibit 10.1 to Form 8-K filed on April 15, 2009, and hereby incorporated by reference.
10.13*	Registrant s 2008 Non-Employee Directors Stock Option Plan filed as Exhibit B to Form 14A filed on January 28, 2008, and hereby incorporated by reference
10.14*	Registrant s 2008 Employee Stock Purchase Plan filed as Exhibit C to Form 14A filed on January 28, 2008, and hereby incorporated by reference
10.15*	Registrant s 2009 Stock Incentive Plan filed as Exhibit A to Form 14A filed on January 28, 2009, and hereby incorporated by reference
10.16	Loan and Security Agreement executed as of March 5, 2010 among registrant, Sonic Foundry Media Systems, Inc., and Partners for Growth II, L.P., filed as exhibit 10.1 to Form 8-K filed on March 10, 2010.
10.17	Revolving Loan Agreement executed as of March 5, 2010 among registrant, Sonic Foundry Media Systems, Inc., and Partners for Growth II, L.P., filed as exhibit 10.2 to Form 8-K filed on March 10, 2010.
10.18	Warrant Purchase Agreement executed as of March 5, 2010 among registrant and Partners for Growth II, L.P., filed as exhibit 10.3 to Form 8-K filed on March 10, 2010.
10.19	Warrant executed as of March 5, 2010 among registrant and Partners for Growth II, L.P., filed as exhibit 10.4 to Form 8-K filed on March 10, 2010.
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32	Section 906 Certification of Chief Executive Officer and Chief Financial Officer

Registrant will furnish upon request to the Securities and Exchange Commission a copy of all exhibits, annexes and schedules attached to each contract referenced in item 10.

* Compensatory Plan or Arrangement

Table of Contents

SIGNATURES

Pursuant to the requirement of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Sonic Foundry, Inc.

(Registrant)

May 3, 2010	By: /s/ Rimas P. Buinevicius Rimas P. Buinevicius Chairman and Chief Executive Officer
May 3, 2010	By: /s/ Kenneth A. Minor Kenneth A. Minor Chief Financial Officer, Chief Accounting Officer and Secretary